

Message Text

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CIEP-01 SS-15 STR-04 TAR-01 TRSE-00 USIA-06 PRS-01

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R 152322Z APR 75

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 0238

INFO AMEMBASSY BONN

AMEMBASSY BRUSSELS

AMEMBASSY COPENHAGEN

AMEMBASSY DUBLIN

AMEMBASSY LUXEMBOURG

AMEMBASSY PARIS

AMEMBASSY ROME

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AMEMBASSY TOKYO

USMISSION EC BRUSSELS

USMISSION OECD PARIS

USMISSION GENEVA

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C O N F I D E N T I A L SECTION 01 OF 03 LONDON 05725

DEPARTMENT PASS TREASURY AND FRB

NEW DELHI PASS SECRETARY SIMON'S PARTY

E.O. 11652: GDS

TAGS: ECON, UK, EFIN

SUBJECT: CHANCELLOR HEALEY'S APRIL 15 BUDGET, A SUBJEC-
TIVE OVERVIEW

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REF: LONDON 4986

SUMMARY: CHANCELLOR'S BUDGET APPEARS MILDLY DEFLATIONARY GIVEN THE ECONOMIC CONTEXT. HEALEY PLACED BLAME FOR DOMESTICALLY GENERATED INFLATION AND THE NEED FOR A TWO PERCENTAGE POINT INCREASE IN PERSONAL TAX RATE DIRECTLY ON THE UNIONS THAT FAILED TO OBSERVE SOCIAL CONTRACT. HE STRESSED NEED TO RETAIN CONFIDENCE OF INTERNATIONAL CREDITORS WHOSE TRANSITIONAL SUPPORT WILL BE NECESSARY TO U.K. ADDING THAT BY RELYING UNDULY ON BORROWING, U.K. WOULD RUN RISK OF BEING FORCED TO ACCEPT POLITICAL AND ECONOMIC CONDITIONS IMPOSED BY THE WILL OF OTHERS, WHICH WOULD REPRESENT AN UNEQUIVOCAL LOSS OF SOVEREIGNTY. HEALEY MADE DISTINCTION BETWEEN TACTICS AND STRATEGY. BALANCE OF PAYMENTS WILL CONTINUE TO SHOW IMPROVEMENT IN 1975, BUT MICROECONOMIC MEASURES WILL BE TAKEN TO HELP ASSURE THAT U.K. LABOR FORCE AND PRODUCTIVE CAPACITY ARE CAPABLE OF MEETING INCREASED EXPORT DEMAND AS RESULT OF EXPECTED GROWTH IN WORLD TRADE IN 1976. HEALEY STRESSED NEED FOR MAJOR COUNTRIES TO REFLATE, INDICATED HE WOULD REVIEW U.K. SITUATION IF THEY DID NOT. GOVERNMENT PLANS TO PROVIDE FACILITIES TO GUARANTEE LOANS FOR PRESHIPMENT FINANCE ON LARGE EXPORT PROJECTS AND TO EASE PRICE CODE TO PROMOTE INVESTMENT IN EXPORTS. GOVERNMENT'S BORROWING REQUIREMENT EXPECTED TO INCREASE FROM 6.3 BILLION POUNDS IN FISCAL 1974-75 TO ABOUT 9 BILLION POUNDS IN FISCAL 75-76, WHICH HEALEY SAID WILL REMAIN ROUGHLY 10 PERCENT OF GNP IN REAL TERMS. RISING UNEMPLOYMENT EXPECTED TO REACH FOUR PERCENT OF LABOR FORCE, POSSIBLY A MILLION UNEMPLOYED BY THE END OF THE YEAR. PUBLIC SECTOR BORROWING REQUIREMENT WOULD HAVE REACHED 10 BILLION POUNDS IN FY75-76 IF NOT OFFSET BY VARIOUS INCREASES IN TAXATION, INCLUDING A 25 PERCENT LEVEL OF VAT INTRODUCED ON LUXURIES, IN ADDITION TO TWO PERCENTAGE POINT INCREASE IN PERSONAL AND ADVANCED CORPORATION TAX. NORMAL VAT RATE REMAINS 8 PERCENT. TAXES ON ALCOHOL AND TOBACCO ALSO INCREASED. SERIES OF POLITICALLY POPULAR TAX RELIEF MEASURES ALSO INTRODUCED. LOOKING AHEAD, HEALEY SAID HE WILL MAKE CUTS IN PUBLIC EXPENDITURE IN THE NEXT FISCAL YEAR (76-77), SOME OF WHICH ALREADY ANNOUNCED. END SUMMARY

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1. THIS MESSAGE IS DESIGNED AS A SUBJECTIVE AND BRIEF SUMMARY OVERVIEW OF HEALEY'S BUDGET PRESENTATION TO PARLIAMENT ON APRIL 15. IN ADDITION, SEPARATE MESSAGES ON THE DOMESTIC AND INTERNATIONAL ASPECTS OF THE BUDGET HAVE BEEN SENT AND SHOULD BE READ FOR A ROUNDED AND MORE COMPLETE ASSESSMENT OF THE OVER-ALL MEASURES AND THEIR IMPLICATIONS.

2. HEALEY WAS ON HIS FEET FOR TWO HOURS AND 16 MINUTES GOING THROUGH WHAT AT TIMES SEEMED ALMOST A LABORIOUSLY LONG LITANY THAT RANGED FROM MEDIUM-TERM MACROECONOMIC STRATEGY TO AN INCREASE IN THE TAXATION ON BINGO PARLORS. DURING HIS PRESENTATION, HE SIPPED, FROM A CARAFE OF WHAT APPEARED TO BE BRANDY OR WHISKEY AND WATER. HIS BASIC MESSAGE AIMED AT DOMESTIC AUDIENCE BOTH IN WORDS AND TONE OF PRESENTATION WAS THAT THE TRADE UNIONS THAT HAD NOT ADHERED TO THE SOCIAL CONTRACT MUST BEAR THE BLAME FOR THE CURRENT DOMESTICALLY GENERATED INFLATION IN THE U.K. ECONOMY. HE MADE THIS POINT IN ANNOUNCING A 2 PERCENTAGE POINT INCREASE ON BASIC RATES OF TAXATION FOR ALL TAXPAY-

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R 152322Z APR 75

FM AMEMBASSY LONDON

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ERS EXCEPT THOSE AT THE VERY HIGHEST LEVEL (I.E., 83 PERCENT), CALLING IT A TAX ON INFLATION. HE ALSO INCREASED THE LEVEL OF PERSONAL EXEMPTIONS AND SOME SELECTIVE BENEFITS WHICH SHOULD PROVE POLITICALLY POPULAR TO THE LABOR PARTY. HE WARNED THAT UNEMPLOYMENT WOULD CONTINUE TO RISE DURING THE COURSE OF THE YEAR TO FOUR PERCENT OR ABOUT ONE MILLION UNEMPLOYED, EVEN AS INFLATION BEGAN TO BE
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BROUGHT UNDER CONTROL. HE CONSIDERED THAT THE MEASURES HE WAS ANNOUNCING MIGHT INCREASE THE RETAIL PRICE INDEX BY 2-3/4 PERCENT BUT WAS HOPEFUL THAT BY THE END OF THE YEAR THE RATE OF INCREASE, CURRENTLY 20 PERCENT, MIGHT BE BROUGHT DOWN TO THE RANGE OF 12 TO 16 PERCENT IF ALL GOES WELL.

3. A SECOND MAJOR POINT WAS THE NEED TO CONTINUE RESTRUCTURING THE U.K. ECONOMY TO PROVIDE FOR INVESTMENT AND EXPORT LED GROWTH AND TO TAKE ADVANTAGE OF THE FORTHCOMING SHARP INCREASE IN WORLD TRADE (10-15 PERCENT) THAT HEALEY ANTICIPATES IN 1976. MICROECONOMIC MEASURES INCLUDING WORKER TRAINING AND SELECTIVE INVESTMENT SCHEMES WILL BE OFFERED TO BE SURE THAT THE INDUSTRIAL STRUCTURE IS IN SHAPE TO MEET THIS INCREASED DEMAND WHEN IT ARRIVES. THE GOVERNMENT PLANS TO PROVIDE FACILITIES TO GUARANTEE LOANS FOR PRE-SHIPMENT FINANCE ON LARGE EXPORT PROJECTS (NO DETAILS YET AVAILABLE -- THEY WILL BE ANNOUNCED IN THE NEXT FEW DAYS) AND WILL EASE THE PRICE CODE TO COVER INVESTMENT FOR EXPORTING.

4. IN REVIEWING THE PAST YEAR, HEALEY NOTED THAT THE U.K. HAD ENTERED 1974 WITH A BALANCE OF PAYMENTS DEFICIT OF ROUGHLY 3 PERCENT OF GNP. OIL PRICE INCREASES HAD RAISED THE U.K.'S COST OF OIL BY 2.9 BILLION POUNDS. THE 1974 CURRENT ACCOUNT DEFICIT INCREASED TO 3.8 BILLION POUNDS, ROUGHLY 5 PERCENT OF GNP. DURING 1975 THE U.K. EXPECTS A REDUCTION IN THE DEFICIT OF ABOUT ONE BILLION POUNDS, IMPLYING A SURPLUS ON NONOIL TRADE. THE CONSEQUENCES OF THE OIL CRISIS HAD BEEN A HEAVY BLOW TO REAL INCOME IN THE UK; IT ALSO INCREASED INFLATION AND CAUSED THE SHARP SLOWDOWN IN WORLD GROWTH WHICH THE U.K. HAD FORESEEN BETTER THAN MOST. HEALEY STRESSED THE NEED FOR STRONGER INDUSTRIAL COUNTRIES TO REFLATE THEIR ECONOMIES AND CITED

RECENT MEASURES IN GERMANY AND THE U.S. AS GOOD SIGNS.
HOWEVER, IF REFLATIONARY MEASURES IN STRONGER COUNTRIES
PROVE INSUFFICIENT HE WOULD HAVE TO REVIEW THE ADEQUACY
OF THE MEASURES HE HAD TAKEN TO MAINTAIN EMPLOYMENT IN
BRITAIN. LOOKING AHEAD, HE FORESAW A SMALLER CUMULATIVE
PETRODOLLAR SURPLUS THAN ORIGINALLY ESTIMATED, PERHAPS IN
THE RANGE OF 250 BILLION DOLLARS BY 1980.
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5. HAD IT NOT BEEN FOR HIS INCREASED TAXATION MEASURES,
HEALEY SAID THE BORROWING REQUIREMENT IN FY75-76 WOULD
HAVE REACHED 10 BILLION POUNDS RATHER THAN ROUGHLY THE
ONLY 9 BILLION WHICH HE CONCLUDED WAS EQUIVALENT
IN REAL TERMS TO THE BORROWING REQUIREMENT IN THE PRE-
CEDING FISCAL YEAR. THIS BORROWING REQUIREMENT WOULD BE
KEPT IN BOUNDS THIS YEAR THROUGH INCREASED TAXATION AND
PERHAPS REDUCED NEXT YEAR BY CUTS IN THE GROWTH OF PUBLIC
EXPENDITURE. SOME SPECIFIC PUBLIC EXPENDITURE CUTS FOR
FY76-77 WERE ANNOUNCED. HEALEY SAID HE PLANS TO KEEP THE
GROWTH OF MONEY SUPPLY UNDER FIRM CONTROL ALTHOUGH THROUGH
OUT THIS PORTION OF THE PRESENTATION, GORDON RICHARDSON,
THE GOVERNOR OF THE BANK OF ENGLAND, SAT GRIM LOOKING AND
STONE FACED. THE GOVERNMENT'S ABILITY TO FINANCE THE

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R 152322Z APR 75
FM AMEMBASSY LONDON
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INFO AMEMBASSY BONN
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BORROWING REQUIREMENT IN A LARGELY NON-INFLATIONARY WAY
REMAINS TO BE TESTED, AND WILL DEPEND IN LARGE PART ON
THE GOVERNMENT'S ABILITY TO LIMIT THE INCREASE IN GROWTH
OF PUBLIC EXPENDITURE AT ALL LEVELS.

6. THE ONE ELEMENT OF HUMOR IN AN OTHERWISE RATHER COLOR-
LESS PRESENTATION CAME WHEN HEALEY WAS ANNOUNCING HIS
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DUAL VAT SYSTEM WITH A 25 PERCENT RATE ON LUXURIES; DURING
HIS ENUMERATION OF THEM, HE PAUSED AND LOOKED DIRECTLY
AT FORMER PRIME MINISTER HEATH AND SAID, "BOATS." THE
HOUSE -- EXCEPT FOR HEATH -- EXPLODED INTO LAUGHTER.

7. HEALEY STRESSED THE NEED TO MAINTAIN THE CONFIDENCE
OF FOREIGN CREDITORS AS THE U.K. PASSED THROUGH A TRANSI-
TIONAL PERIOD. HE NOTED THE SLOWDOWN IN THE ESTIMATED
DEVELOPMENT AND PAYOUT OF NORTH SEA OIL ANNOUNCED THIS
WEEK. IF THE COUNTRY COULD NOT INCREASE INVESTMENT,
PRODUCTIVITY AND EXPORTS AND PAY ITS OWN WAY INTERNATION-
ALLY, THE ALTERNATIVES WOULD BE GRIM.

8. COMMENT: THE EMBASSY'S IMPRESSION IS THAT HEALEY DID
NOT PULL HIS PUNCHES IN CORRECTLY ANALYZING THE DIFFICUL-
TIES AND DANGERS FACING THE U.K. ECONOMY. HIS EXPOSITION
HAD AN OBVIOUS LABOR PARTY TINT TO IT, AT TIMES EXTOLLING
THE BENEFITS OF COOPERATION BETWEEN THE GOVERNMENT AND

THE PRIVATE SECTOR, BUT HE DID STRESS THE NEED FOR A HEALTHY AND ACTIVE PRIVATE SECTOR WITHIN THE OVER-ALL ECONOMIC FRAMEWORK. GIVEN THE DIFFICULTIES FACING THE GOVERNMENT AND THE SCHISMS WITHIN THE LABOR PARTY ITSELF, THE BUDGET WAS FAIR AND RESPONSIBLE. IN A BRIEF CONVERSATION, OPPOSITION MP THOUGHT THE OVER-ALL MESSAGE WAS POLITICALLY ASTUTE IN DOMESTIC TERMS, BUT EXPECTED THAT THE LEFT WING OF THE LABOR PARTY AS WELL AS THE TRADE UNIONS WOULD NOT BE PLEASED. EMBASSY CONSIDERS THIS A FAIR COMMENT.

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